(12)

No. 94-560

In the
Supreme Court of the United States

OCTOBER TERM, 1994

FIRST OPTIONS OF CHICAGO, INC.,
PETITIONER,

v.

MANUEL KAPLAN, CAROL KAPLAN
AND M.K. INVESTMENTS, INC.,
RESPONDENTS.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF OF THE SECURITIES INDUSTRY ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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AND M.K. INVESTMENTS, INC.,
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**ON WRIT OF CERTIORARI
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BRIEF OF THE SECURITIES INDUSTRY ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

STATEMENT OF INTEREST OF THE AMICUS CURIAE

The Securities Industry Association ("SIA") is the principal trade association of the securities industry, with more than 750 member firms in the United States and Canada. As a member of the Securities Industry Conference on Arbitration, the SIA has been intimately involved in the evolution of the arbitration process. The SIA and its members, which now use arbitration to resolve over five thousand claims annually, have a significant interest in ensuring that the process provides a

mechanism for resolving disputes quickly, efficiently, economically and fairly.

The SIA has participated as *amicus curiae* in several cases, including *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. 213 (1985), and *Rodriguez de Quijas* v. *Shearson/American Express, Inc.*, 490 U.S. 477 (1989), arguing successfully that the courts should require parties to honor pre-dispute agreements to arbitrate a specified claim or category of claims. It also has submitted an *amicus curiae* brief in *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, No. 94-18, arguing that where the parties to an arbitration agreement explicitly chose to incorporate the law of a state which does not permit arbitrators to award punitive damages, the courts should enforce their contract and vacate any punitive damage award issued by the arbitrators. The principle guiding the SIA in these and similar cases is that which underpins the Federal Arbitration Act: the agreement of the parties should be enforced according to its terms.

The same principle is implicated in this case. The SIA believes it is important to the legitimacy of the arbitral system that the courts be available to determine whether the arbitrators have acted within the bounds of the power provided to them by the parties. By assuring adherence to the terms of the arbitration agreement, the availability of *de novo* judicial review fosters use of arbitral processes. The SIA's member firms thus have a substantial interest in the continued availability of post-award review of the scope of the arbitrators' authority.

The parties have consented to the filing of this amicus curiae brief.

SUMMARY OF ARGUMENT

In ruling on a motion to vacate under Section 10(a)(4) of the Federal Arbitration Act, 9 U.S.C. §§ 1-16, a federal district court should not defer to the arbitrators' conclusions concerning the scope of their power, unless the parties have clearly and unmistakably agreed to be bound by the arbitrators' determination.[1] Absent such agreement, the question of the scope of the arbitrators' authority remains the responsibility of the courts, whether it arises prior to arbitration in the context of a motion to compel arbitration under Section 4 of the Act or in a motion to vacate under Section 10 of the Act.

The assurance, absent contrary agreement, of plenary judicial review of the scope of the arbitrators' authority encourages parties to submit issues to arbitration. Truncating post-award review of the arbitrators' authority would force increased resort to the courts prior to arbitration in cases which otherwise may well be resolved without judicial intervention.

Accordingly, the Court should rule that the Court of Appeals properly did not defer to the arbitrators on the question of their power, once it had determined that the parties had not agreed that the arbitrators were to determine their own authority.

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[1] The SIA takes no position on whether such a clear and unmistakable agreement existed here.

ARGUMENT

THE COURT OF APPEALS PROPERLY RULED THAT THE ARBITRABILITY OF THE DISPUTE WAS SUBJECT TO DE NOVO JUDICIAL REVIEW ON A MOTION TO VACATE.

In ruling on the individual Respondents' motion to vacate the arbitration award under Section 10(a)(4) of the Federal Arbitration Act, the Court of Appeals did not defer to the arbitrators' conclusion that the individual Respondents were obligated to arbitrate their dispute with Petitioner. Since it found that the individual Respondents had not "clearly indicated [their] willingness to forego judicial review" of the arbitrability of the dispute, the Court of Appeals properly concluded that review of the question of the arbitrators' authority should be *de novo*. App. A-21.

The SIA is not addressing the Court of Appeals conclusion that the individual Respondents did not waive judicial review of the arbitrators' authority.[2] Rather, the issue of importance to the SIA is the standard of judicial review of the arbitrators' authority, assuming that an objection to the arbitrators' jurisdiction is properly preserved.

A. The question of whether the parties agreed to arbitrate is to be decided by the court, unless the parties "clearly and unmistakably" provide otherwise.

Under the Federal Arbitration Act, the determination of the arbitrability of a dispute, including whether an arbitration agreement exists or is applicable, is for the courts to make, absent contrary agreement. *See Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-04 (1967) (stating that under the Federal Arbitration Act the question of fraud

[2] The SIA also is not addressing the question of whether the Court of Appeals applied the appropriate scope of appellate review.

in inducement of the agreement to arbitrate is for judicial determination). In the context of labor arbitrations, this Court has held:

> [T]he question of arbitrability . . . is undeniably an issue for judicial determination. ***Unless the parties clearly and unmistakably provide otherwise***, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator.

AT&T Technologies, Inc. v. *Communications Workers of America*, 475 U.S. 643, 649 (1986) (emphasis added); *see also Wiley & Sons, Inc.* v. *Livingston*, 376 U.S. 543, 546-47 (1964) ("'Under our decisions, whether or not the company was bound to arbitrate, as well as what issues it must arbitrate, is a matter to be determined by the Court on the basis of the contract entered into by the parties.'") (citations omitted).

This Court's reasoning in the context of labor arbitration is equally applicable in commercial arbitrations. "The willingness of the parties to enter into agreements that provide for the arbitration of specified disputes would be 'drastically reduced,' . . . if a labor arbitrator had the 'power to determine his own jurisdiction. . . .'" *AT&T Technologies*, 475 U.S. at 651 (citations omitted).

Moreover, the provisions of the Federal Arbitration Act manifest a clear policy that the authority of the arbitrators is to be determined by the courts. Section 4 of the Act allows a party aggrieved by the refusal of another to arbitrate to bring a motion to compel arbitration. In a proceeding under Section 4, the question of the making of an arbitration agreement is explicitly assigned to the judiciary. *See Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985). Similarly, Section 10 of the Act, discussed more fully below, provides that a district court may vacate an arbitration award, "Where the arbitrators exceeded their powers. . . ."

B. Section 10(a)(4)'s authorization of vacatur where an award exceeds the arbitrators' powers encompasses the authority to vacate an award where there is no agreement to arbitrate.

Section 10(a)(4) of the Federal Arbitration Act authorizes a court to vacate an award that exceeds the authority of the arbitrators. An arbitral award where a party has not agreed to arbitrate is, without doubt, beyond the arbitrator's authority. As this Court has emphasized, "[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *United Steelworkers of America* v. *Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960); *see also Volt Information Sciences, Inc.* v. *Board of Trustees*, 489 U.S. 468, 479 (1989) ("Arbitration under the Act is a matter of consent, not coercion. . . .").

The Court of Appeals in this case concluded that the individual Respondents had not "clearly indicated [their] willingness to forego judicial review" of their objections to the arbitrators' jurisdiction. App. A-21 (citation omitted). Based on this conclusion, the Court of Appeals properly determined that the question of the existence of an agreement to arbitrate, raised by the motion to vacate under Section 10(a)(4), was subject to judicial review.

The logic of the Court of Appeals here is fully consistent with that of other appellate courts which have discussed the question. For example, in *Davis* v. *Chevy Chase Fin. Ltd.*, 667 F.2d 160 (D.C. Cir. 1981), the Court of Appeals held that an arbitrator's award should be vacated under Section 10(d) of the Act (later renumbered Section 10(a)(4)) because he had exceeded his powers by deciding issues beyond those assigned to him by agreement. The Court reasoned that, "[A]n arbitral award regarding a matter not within the scope of the governing arbitration clause is one made in excess of authority,

and a court is precluded from giving effect to such award." *Id.* at 165; *see Humphrey* v. *Prudential Securities Inc.*, 4 F.3d 313, 319 (4th Cir. 1993) (stating that issue of whether "arbitrators exceeded the scope of arbitration agreed to by the parties by reviewing [plaintiff's] claims" may be raised on motion to vacate an award). Indeed, case law upon which Petitioner relies states that an objection to the jurisdiction of an arbitrator, if properly preserved, is subject to judicial review on a motion to vacate the arbitration award. *See George Day Constr. Co.* v. *United Bhd. of Carpenters, Local 354*, 722 F.2d 1471, 1476 (9th Cir. 1984) ("the employer merely had to voice its objection on the arbitrability issue and state on the record that it was reserving that question for later judicial determination. In this way, the question could be preserved for *independent judicial scrutiny* at any subsequent proceeding for vacatur or enforcement.") (emphasis added); *Van Waters & Rogers Inc.* v. *International Bhd. of Teamsters, Local Union 70*, 913 F.2d 736, 740 (9th Cir. 1990) (finding that the issue of arbitrability had been properly reserved under *George Day* and accordingly was subject to judicial review).

Allowing an arbitral award to be challenged under Section 10(a)(4) on the grounds that there is no agreement to arbitrate is, moreover, directly analogous to other challenges which courts have permitted pursuant to that provision. For example, under Section 10(a)(4) courts have accepted challenges to arbitrators' authority to determine particular issues[3] and to award particular forms of relief.[4] We are aware

[3] *See, e.g., Edward D. Jones* v. *Sorrells & Co.*, 957 F.2d 509, 512 (7th Cir. 1992) (affirming grant of motion to vacate under Section 10(d) of the Federal Arbitration Act where certain claims were ineligible for arbitration).

[4] *See, e.g., Delta Queen Steamboat Co.* v. *District 2 Marine Engineers Beneficial Ass'n.*, 889 F.2d 599, 602 (5th Cir. 1989) (referencing Section 10(d) of the Federal Arbitration Act and vacating arbitration decision where remedy ordered by arbitrator was beyond his authority under the agreement) and cases cited, *cert. denied*, 498 U.S. 853 (1990).

of no appellate opinion holding that the existence of an agreement to arbitrate is not subject to judicial review under Section 10(a)(4), other than where the parties have clearly and unmistakably agreed that the arbitrators could decide their own jurisdiction.[5] *But cf. Comprehensive Accounting Corp.* v. *Rudell*, 760 F.2d 138, 141 (7th Cir. 1985) (declining to decide whether the validity of an agreement to arbitrate might be litigated in a confirmation proceeding).

Post-award judicial review of the existence of an arbitration agreement is supported not only by the language of Section 10(a)(4) but also by the presumption that issues of arbitrability are to be decided by the courts, not the arbitrators. The absence of a provision in the Act allowing a party resisting arbitration to seek a court-ordered stay of proceedings indicates that Section 10(a)(4) was intended to allow a post-award judicial determination.[6]

In addition, post-award judicial review of the arbitrability question furthers the Congressional policy expressed in the Federal Arbitration Act: "to make arbitration agreements as enforceable as other contracts *but not more so.*" *Prima Paint*,

[5] The fact that a party opposing arbitration may be able to provoke the proponent of arbitration into moving to compel does not mean that post-award judicial review of the existence of an arbitration agreement should be unavailable under Section 10(a)(4). Even though one party objects to arbitration, both parties may be content to defer a judicial determination of arbitrability. This is particularly the case where multiple parties are involved or arbitrable and non-arbitrable issues are involved.

Nevertheless, the ability of the proponent of arbitration to secure a pre-arbitration judicial determination of arbitrability is significant. It means that only if the proponent of arbitration *elects* not to secure a judicial determination of arbitrability by means of a motion to compel does it proceed through arbitration without knowing if the dispute will be held to be arbitrable.

[6] A party who believes that it is not obligated to arbitrate a dispute or that certain issues are not arbitrable may seek to enjoin the arbitration. That remedy, however, is not one arising under the Federal Arbitration Act and should not reflect on the scope of appropriate review under Section 10(a)(4).

388 U.S. at 404 n.12 (emphasis added). Judicial scrutiny of arbitrability encourages the use of arbitration by assuring the parties that their agreement to arbitrate will be honored according to its terms. *See AT&T Technologies*, 475 U.S. at 643.

Finally, recognizing that Section 10(a)(4) may be used to secure a judicial determination of whether an agreement to arbitrate exists also harmonizes federal law with the Uniform Arbitration Act, in force in the majority of state jurisdictions. That Act explicitly provides in Section 12 that:

> Upon application of a party, the court shall vacate an award where:
>
> • • •
>
> (5) There was no arbitration agreement and the issue was not adversely determined in proceedings under Section 2 [governing motions to compel and to stay] and the party did not participate in the arbitration hearing without raising the objection;

7 U.L.A. 140 (1955). Reading Section 10(a)(4) to allow post-award challenges to an arbitrator's authority thus avoids generating opportunities for forum shopping.

C. Unless the parties have clearly and unmistakably agreed to be bound by the arbitrators' determination of their own authority, a court's review of arbitrability under Section 10(a)(4) is *de novo* and a decision by the arbitrators that the dispute is arbitrable is not entitled to deference.

Arbitrators may, on their own initiative or at the request of a party, rule on the question of arbitrability of a dispute. As long as the party resisting arbitration does not consent to

its resolution by the arbitrators,[7] the arbitrators' decision on arbitrability should not be accorded the deference given to a decision on the merits. The Court of Appeals here observed, "An arbitrator's decision to assert jurisdiction over objection is . . . subject 'to a much broader and more vigorous judicial review' than an arbitral decision on the merits. Because it is 'a question for the court to decide,' it is subject to *de novo* judicial review." App. A-22-23 (quoting *International Bhd. of Teamsters, Local 249* v. *Western Pennsylvania Motor Carriers Assn.*, 574 F.2d 783, 787 (3d Cir. 1978), *cert. denied*, 439 U.S. 828 (1978)); *see also International Ass'n. of Machinists, Lodge No. 1777* v. *Fansteel, Inc.*, 900 F.2d 1005, 1010 (7th Cir. 1990) ("While we note that the arbitrator attempted to decide the arbitrability question, the resolution of this question is our responsibility and we will approach this issue *de novo* without deference to the arbitrator's decision."), *cert. denied*, 498 U.S. 851 (1990); *Davis*, 667 F.2d at 167 (rejecting argument that "an agreement to arbitrate an issue carries with it a concomitant power to determine arbitrability with limited judicial review") Judicial review of merits decisions is sharply restricted in order to further the parties' choice to have the dispute resolved by arbitrators, not the courts. *United Papermakers Int'l Union* v. *Misco, Inc.*, 484 U.S. 29, 36-38 (1987).

A decision concerning the arbitrator's authority to resolve a particular dispute is altogether different. As with questions about whether a specific issue is within the scope of the arbitration agreement or whether the arbitrator has authority to utilize a particular remedy, the question of arbitrability goes to the legitimacy of the dispute-resolution process. That legitimacy stems from the contract between the parties.

[7] Participating in an arbitration without seeking injunctive relief should not be construed as "clear and unmistakable" agreement to allow the arbitrators to determine arbitrability. Such a requirement would force a party who believes that a dispute in whole or part is not arbitrable to seek judicial intervention. Since the arbitration process may eliminate or narrow the questions which the courts need to address, forcing pre-arbitration resort to the courts may be in the interest of neither the parties nor the judiciary.

Further, truncating post-award review of arbitrability, or other questions of the arbitrators' authority, would have undesirable consequences. Parties wishing to preserve their position that a dispute was not arbitrable would be forced to seek to enjoin the arbitration proceedings before they occurred, increasing the demand on judicial resources and the expense to the litigants.[8] *See Fansteel*, 900 F.2d at 1009 ("in permitting an arbitrator to attempt to address a dispute prior to judicial arbitrability determination, parties may well be able to resolve their disputes without requiring the involvement of the judiciary."); *Davis*, 667 F.2d at 168 (limiting post-award review of arbitrability "might actually *foster* litigation by requiring parties to seek 'interlocutory' review of jurisdictional rulings"). To the extent that post-arbitration relief were unavailable, parties would be discouraged from entering into agreements to arbitrate specified disputes by the knowledge that the arbitrators might exercise jurisdiction more broadly than intended. *AT&T Technologies*, 475 U.S. at 651.

Conclusion

Having determined that the parties did not agree that the arbitrators could determine their own jurisdiction, the Court of Appeals properly ruled that the arbitrators' conclusion on arbitrability was not entitled to deference and that *de novo* judicial review of the existence of an arbitration agreement was appropriate pursuant to the individual Respondents' motion to vacate under Section 10(a)(4) of the Federal Arbitration Act. We urge that the Court follow the reasoning of the Court of Appeals in this regard in order to facilitate the

[8] In multi-party cases such as this one, pre-arbitration judicial proceedings may well slow the arbitration process by causing the resolution of admittedly arbitrable disputes or issues to be deferred pending the judicial ruling. Experience, including that under the Uniform Arbitration Act, does not suggest that post-award judicial review of arbitrability has negatively affected the arbitration process.

effective enforcement of agreements to arbitrate by their terms, as Congress intended.

Respectfully submitted.

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